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Preventive Restructuring Frameworks: A Possible Solution for Financially Distressed Multinational Corporate Groups in the EU

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Abstract:
The difficulties of the effective rescue of multinational corporate groups (MCGs) in the EU have long been recognized. The limitations of the existing MCG rescue solutions, including substantive consolidation, procedural consolidation and procedural cooperation, mean that there is no panacea for preserving the value of financially distressed MCGs for creditors. It seems that a possible way to preserve the value of the MCGs worth rescuing is to avoid their free-fall insolvency at an early stage. In practice, many pan-EU groups decide to use English schemes of arrangement to stave off group-wide insolvency. This phenomenon corresponds to the recent European Commission's proposal for a Directive on preventive restructuring frameworks (PRFs) which aims to provide Member States with a minimum harmonization of restructuring tools to rescue financially distressed companies and to avoid their insolvency. Also, the new EU Regulation on insolvency proceedings has expended its scope to incorporate preventive restructuring procedures. This article will explore how preventive restructuring frameworks can work as a supplementary solution to preserve value for MCGs and examine whether this may improve the undesirable status quo.

Keywords: Multinational corporate groups; Corporate rescue; Preventive restructuring frameworks; EIR recast

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1 Introduction

In the Europe 2020 Strategy for Jobs and Growth, the European Commission has set as current political priorities promoting economic recovery and sustainable growth, a higher investment rate and preservation of employment; as part of the strategies to achieve the above goals, the reform of insolvency law and adaptation of the rescue culture are believed to be useful in facilitating economic recovery.[1]

As a response, at the EU level, the European Commission issued the 'Restructuring Recommendation on preventive restructuring frameworks (PRFs)' in 2014.[2] Due to the concern that some Member States may not take actions properly,[3] on 22 November 2016, the European Commission further proposed a Directive on PRFs with the aim to help distressed companies with their debt restructurings in the EU and to avoid the stigma of insolvency.[4] In addition, the scope of the new EU Regulation on insolvency proceedings (EIR recast)[5] is expanded so that it encompasses, to a large extent, the rescue-focused (pre-insolvency or hybrid) proceedings of Member States.[6]

The aim of this article is to examine whether the proposed PRFs may, together with EIR recast, add an extra valuable tool to the solutions for multinational corporate group (MCG) rescue in the EU. It first introduces the difficulties of MCG rescue by considering obstacles arising from the goals of corporate rescue law, the organizational form of MCGs and the cross-border nature of MCG insolvency. It examines why substantive consolidation and procedural consolidation may not always be a solution. Secondly, it examines the main functions of the proposed preventive restructuring procedures and exemplifies their usefulness by providing two types of restructuring cases featuring English schemes of arrangement. Thirdly, it evaluates the nature of PRFs as to whether they are insolvency proceedings and the relationship between PRFs and EIR recast. It also briefly considers the possibility for PRFs and EIR group coordination proceedings to work together for MCG rescue. Lastly, the article also points out the benefits of including PRFs in the scope of EIR recast. The article concludes that PRFs are a welcome development in the right direction with improved ability to avoid MCG insolvency and may therefore provide a better debt recovery rate for creditors.

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[1] Commission Staff Working Document, Executive Summary of the Impact Assessment, Accompanying the document Commission Recommendation on a new approach to business failure and insolvency, SWD(2014) 62 final, p 2.

[2] European Commission, Recommendation of 12 March 2014 on a new approach to business failure and insolvency, C(2014) 1500 final.

[3] McCormack (2017), p 201.

[4] Proposal for a Directive of the European Parliament and of the Council on preventive restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU, COM(2016) 723 final; Yeowart (2009), p 518.

[5] Regulation (EU) 2015/848 of the European Parliament and the Council of 20 May 2015 on insolvency proceedings (recast) [2015] OJ L 141/19-72 (hereinafter: EIR recast).

[6] EIR recast, Art. 1.

2 The difficulties of MCG rescue in the EU

2.1 Introduction of MCGs

It has long been recognized that businesses can be operated at cross-border level through various organizational forms including companies, partnerships and non-equity-based organizations such as franchise agreements.[7] Amongst all these forms, a prevalent form to run business transnationally, especially for large companies,[8] is multinational corporate groups (MCGs) consisting of limited liability companies.[9] MCGs are different from pure domestic corporate groups as they have no clear nationalities. Each member company may incorporate in a different country and obtain its nationality under company law.[10]

What makes the relationship among member companies in MCGs and the ordinary arm's-length market relationship different is the 'controlled internal environment' of MCGs, either by ownership or by contracts.[11] That is to say, MCGs internalize some business activities which otherwise may need to be obtained from the market by ownership or contracts.[12]

Ownership is a typical way for parent companies to exert control on subsidiaries by direct or indirect shareholdings. Under the company law of many Member States, once a parent company holds more than 51% shares of its subsidiaries, it can establish control over them by ownership.[13] Sometimes, *de jure* control can be established by cross-holding whereby three companies mutually hold a certain amount of each other's shares and agree to operate in a uniform way[14] or by a chain-type structure which allows the parent company situated at the top of the group structure to control the subsidiaries far down the hierarchy of the group.[15]

Another way to establish control is by means of contracts. For example, member companies can be connected by distribution agreements where distributors may enjoy exclusive rights to sell the products of other companies.[16] Similarly, member companies may also enter into production agreements whereby the production of certain products is carried out in host countries.[17]

MCGs have the capability of distributing resources across borders, taking advantage of local resources and coordinating the activities of members by exerting control.[18] According to an economic definition, MCGs generally refer to multinational corporate groups whose transnational businesses in two or more states in the EU are controlled and coordinated.

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[7] Mevorach (2009), p 20.

[8] Mevorach (2005), p 4.

[9] Teichmann (2015), p 203.

[10] Blumberg (1993), p 173.

[11] Ho (2012), p 886; Rajak (2009), p 530.

[12] See Sect. 2.3 for more details.

[13] Hopt (2015), p 2.

[14] Prentice (1998-1999), p 313.

[15] Ibid., p 313.

[16] Muchlinski (2007), p 53.

[17] Ibid., p 54.

[18] Ibid., p 8.

Besides the economic definition, it would be very helpful to examine the legal definition of MCGs at the beginning, especially for insolvency law. It should be noted that even though MCGs are the prevalent form of doing business in a cross-border context, specific legal regimes to deal with corporate groups are rare.[19] MCGs in many areas of law are not treated as a whole entity, but as a group of individual companies. In certain areas of law, such as accounting and tax,[20] one MCG has been treated as an economically integrated organization.

To provide a legal definition of MCGs, control may be used to draw the border of a group of companies.[21] The control exerted by parent companies is sometimes reflected by their share ownership in subsidiaries or their power to determine who the board members of subsidiaries are.[22] Some legislation also recognizes the contractual control; one example is EU competition law.[23]

In the area of cross-border insolvency law, the newly released EU Regulation on insolvency proceedings recast (EIR recast) provides a definition of groups of companies by using control as a benchmark. Its definition is as follows:

> (13) 'group of companies' means a parent undertaking and all its subsidiary undertakings; (14) 'parent undertaking' means an undertaking which controls, either directly or indirectly, one or more subsidiary undertakings. An undertaking which prepares consolidated financial statements in accordance with Directive 2013/34/EU of the European Parliament and of the Council (1) shall be deemed to be a parent undertaking.[24]

From the EIR recast, one can notice that control, irrespective of deriving from ownership or contracts, is the main method to define MCGs in legal terms. In this article, MCGs may be defined as a group of companies operating in more than one Member State, cooperating and coordinating with each other to run businesses by means of control established by equity

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[19] De Vette (2011), p 216.

[20] UNCITRAL Legislative Guide on Insolvency Law—Part three, p 14; in the area of accounting, see Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC [2013] OJ L 182/19-76, Art. 2 (9-13); see Art. 3 of Directive 2006/43/EC [2006] OJ L 157/87-107. In tax areas, the corporate groups are allowed to benefit from group relief provisions so as to reduce the tax burden. The main idea of such a mechanism is to allow corporation tax loss members (surrendering companies) to transfer such losses to profit-making members (claimant companies) so as to set off the tax liabilities of the latter. Muchlinski (2007), p 265.

[21] UK Companies Act 2006, c. 46, § 1159(1); UK Corporation Tax Act 2010, Art. 152 on groups of companies; OECD Tax Model, Art. 9.

[22] Blumberg (1990), p 329.

[23] Council Regulation (EC) No. 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation) [2004] OJ L 24/1-22, Art. 3(2)(b) '[m]eans which […] confer the possibility of exercising decisive influence on an undertaking, in particular by: […] (b) rights or contracts which confer decisive influence on the composition, voting or decisions of the organs of an undertaking.'

[24] EIR recast, Art. 2.

holding or contracts. Even though there is no perfect definition of MCGs, the control test generally provides an acceptable definition. More importantly, in some cases, control indicates a degree of business cooperation and coordination in a given group. Insolvency law may want to preserve the complex and delicate relationships to preserve the value of distressed MCGs for creditors in general.[25]

MCGs reportedly generate 30 percent of jobs and 41 percent of gross added value in the EU, and their insolvency has a far-reaching impact on the European economy.[26] The impact may be contagious as cross-border businesses mainly operate through a network of subsidiaries[27] and the financial difficulties of one member company may be passed on to others.[28] Given the significance of MCGs to the EU economy, this article chooses MCGs as a research target and evaluates whether the European Commission's newly proposed Directive for preventive restructuring frameworks is a step in the right direction.

Designing reliable rescue solutions for MCGs should at least take into account three main issues: the purposes of corporate rescue law, the organizational form of MCGs, and the cross-border nature of MCG insolvency. These three features will be briefly examined in turn below.

2.2 The Purpose of Preventive Restructuring Proceedings

To understand the new rescue culture in the EU, it is very helpful to examine the purposes of insolvency law and corporate rescue law. Traditionally, liquidation proceedings are typical insolvency law proceedings which replace creditors' individual actions by a collective insolvency law solution to maximize creditors' recovery from indebted debtors [29]and screen out insolvent companies with unworkable business plans from the market.[30] That is to say that at the micro level, the goal of insolvency law is to protect creditors by maximizing their recovery; at the macro level, an effective insolvency law also helps lower the borrowing interest rates and incentivize investment, and therefore encourages economic growth.

However, in many cases, the value of businesses cannot be fully realized in the market by a break-up sale in liquidation proceedings due to market failures;[31] it is here that corporate rescue law can play a role by preserving businesses as going concerns.[32] Distressed companies with going-concern value are generally named as financially distressed companies which are worth saving mainly through readjusting capital structures.[33] Corporate rescue law either facilitates creditors and debtors to reach a new deal on the capital structure of the distressed companies, or to sell businesses as a whole in a pre-packed sale to a third party who can

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[25] See Sect. 2.2 for more details.

[26] Commission Staff Working Document, Impact Assessment, Accompanying the Document Commission Recommendation on a new approach to business failure and insolvency, SWD(2014) 61 final p 20.

[27] Ibid., p 20.

[28] Ibid., p 2.

[29] Jackson (1986), p 10; Janger (2001), p 566; Mooney Jr. (2004), p 946.

[30] Jackson and Skeel Jr. (2013), p 2.

[31] Market failures may include a lack of buyers, or competition may make such a sale approach less attractive.

[32] Going-concern value, as a key accounting concept, refers to a business that will continue to operate in the future.

[33] Eidenmüller (2017), p 274.

appreciate the going-concern value of the businesses.[34]

Traditionally, corporate rescue law refers to insolvency proceedings which focus on rescue rather than liquidation. To initiate such proceedings, an insolvency test generally needs to be met.[35] The problem is that sometimes it will be too late to rescue the businesses if debtors cannot resort to restructuring tools until the companies are insolvent. Therefore, so-called pre-insolvency proceedings or preventive restructuring proceedings are designed and their aim is to avoid insolvency by encouraging debtors to seek financial support or take relevant actions before insolvency.[36] Different to pure private workouts, pre-insolvency procedures are judicial proceedings with court involvement.[37] By avoiding insolvency, the goodwill or important licences of distressed companies may be protected.[38] In the case of MCG insolvency, it may help to avoid group-wide insolvency by subjecting one or more companies to preventive restructuring procedures. Also, preventive restructuring procedures only demand minimum court involvement and may be cheaper than formal reorganization proceedings.[39]

What preventive restructuring law and traditional corporate rescue have in common is that their ultimate purpose points to creditor protection. The initiation of preventive restructuring proceedings is generally triggered by debtors' foreseeable financial distress, so PRFs also need to deal with collective issues of creditors.[40] Therefore, the purposes of PRFs and corporate rescue procedures are not essentially different. They all aim to protect creditors by respecting their respective rights[41] and preserving debtors' value for distribution.[42]

2.3 Difficulties Arising from the Organizational Forms of MCGs

When it comes to the MCG rescue setting, one may ask two relevant questions. The first is whether going-concern value may exist in MCGs so that they deserve special treatment in corporate rescue law. Another question is whether MCGs can be treated as one company for the purpose of corporate rescue law.

The answer to the first question seems to be affirmative. According to resource-based theory, a company needs to obtain certain resources that are rare and idiosyncratic so as to achieve success in the market.[43] Such resources can be the relationships that the company has formed with its suppliers and customers.[44] For a company, its business partners may well be other member companies in the same group. Because of these relationships, the distress of one company may well be felt by parties linked with this company, and legislators have long been

[34] Baird (1998-1999), p 577.

[35] Cash flow test and balance sheet test. See McCormack (2017), p 180.

[36] Wessels and Madaus (2017), p 183.

[37] Wessels and Madaus (2017), p 175.

[38] Davis et al. (2016), p 22.

[39] Kastrinou and Jacobs (2016), pp 91-92.

[40] Tollenaar (2017), p 74.

[41] Schwartz (2005), p 1220.

[42] See generally Schwartz (2005) and Rotem (2008).

[43] Barney (1991), pp 99-120; Conner (1996), pp 477-501.

[44] Wheeler et al. (2003), p 3.

aware of this effect on the wider world.[45]

The knowledge-based theory[46] further argues that the capability of a given company to use knowledge and to transfer and coordinate different knowledge is also an important resource.[47] The possession of rare resources and the capabilities to use the resources together allow one company to be more efficient than others as that company can use its assets in the most productive way.[48] Besides other resources, the knowledge possessed by groups of companies is invaluable and the key for groups of companies is to transfer and coordinate the knowledge to produce advantages.[49]

Companies which do not possess rare resources or the capabilities to use them will not be able to win from competitors which can use them to produce more profits in the market.[50] As a result, these companies may suffer negative cash flows and become insolvent in the future. Due to the rare resources and capabilities, the additional value that a company can gain can be considered as the going concern value of that company.[51]

Internalization theory[52] explains the organizational form of MCGs and provides that MCGs may choose to internalize certain activities to reduce transaction costs in arm's-length transactions in the market. In other words, the imperfection of markets causes MCGs to locate some of the business activities inside a group whereby the transaction costs can be reduced.[53] Transaction costs deriving from unbounded rationality[54] and opportunism[55] make the contracts of knowledge transfer costly.[56] MCGs will expand their business to other countries if they can gain more net benefits from managing the interdependent subsidiaries' relationships than they can in the domestic market.[57] Therefore, internalization theory and resource-based theory together indicate that it is possible for certain MCGs to have the group going-concern value among their relationships[58] which should be preserved for the purpose of corporate rescue law.

The answer to the second question is likely to be negative. It is well-established that a company has independent legal status; the limited liability and legal personality are core features of companies which generate economic efficiency by lowering the costs of doing business.[59] For instance, by enabling companies to own properties, shares can easily be transferred from sellers to buyers without costs arising from the transfer of business; limited

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45 Dahlin et al. (2005), p 5.

46 Grant (1996), pp 109-122.

47 Kogut and Zander (1993), p 625.

48 Makadok (2001), pp 387–401; Rasmussen and Skeel Jr. (1995), p 86.

49 Grant (1996), p 120.

50 White (1994), p 1319.

51 Harner (2015), p 512.

52 Rugman (2009); Buckley and Strange (2011).

53 Galanis (2011), p 331; see also Coase (1937), pp 386–405.

54 The difficulty of absorbing and understanding complicated information.

55 The contractual parties may pursue self-interest.

56 Rugman (1986), p 109.

57 Hennart (2009), p 133.

58 Dyer and Singh (1998), p 661; Gulati et al. (2000), p 207.

59 Mevorach (2009), p 41.

liabilities of investors also encourage businessmen to engage in their business activities.[60]

As opposed to a single company, an MCG encompasses more than one company in the same group. The doctrine of *substantive consolidation* sees an MCG as one single company in an insolvency context and aims to distribute the total assets of the group to all the creditors under one set of rules.[61]

The benefits of substantive consolidation exist mainly in two types of cases. A typical scenario in the first group is that the debtor group is functioning as one entity, and it is in line with creditors' expectations at the time of making lending decisions to treat a group of companies as one entity; such practice will provide a quick solution to the given cases.[62] Another type of cases is that the assets and liabilities of the debtor group are messily entangled together and very costly to untie; therefore, it is in the interest of creditors to treat the group as one entity.[63]

However, in practice, substantive consolidation is only applied in extreme cases, including situations where one subsidiary's veil needs to be lifted or where assets of one corporate group are tightly intertwined which makes it costly to divide them into respective companies.[64]

The UK court may show reluctance to apply substantive consolidation. In a UK case, *Re Polly Peck International plc*,[65] where the administrator requested substantive consolidation, and the UK court denied the argument that one Special Purpose Vehicle (SPV) subsidiary is just the façade of the given company and thereby should be substantively consolidated. The UK court insisted that using SPVs solely for the purpose of finance is common practice, even if creditors are harmed by group structures.[66] There is no necessity to transplant the concept of substantive consolidation to UK case law.[67]

In Europe, such a concept may be subject to different interpretations by various Member States and it could therefore be difficult to reach consensus regarding its use. Also, substantive consolidating companies located in different Member States into one country will dramatically change the applicable insolvency law, which may not be expected by the local creditors.[68] The best example is the different priority rankings of creditors in different Member States' insolvency laws. One creditor may be in the top ranking under local insolvency law, while he may be demoted to a second or even lower ranking under another country's insolvency law. The size of each debtor's assets is also different, so the result of substantive consolidation will benefit some general creditors at the expense of others.

One may argue that MCG insolvency cases may not necessarily belong in the category of the above extreme cases. Substantive consolidation frequently means that all creditors from different companies in a given group will be subjected to one set of insolvency rules; as opposed to the insolvency rules of creditors' home countries, this set of rules may not be expected by

[60] Ibid., p 41.

[61] Graulich (2006), p 527.

[62] *In re Standard Brands Paint Co.*, 154 BR 563, 573 (Bankr. C.D. Cal. 1993).

[63] *Union Saving Bank v. Augie/Restivo Banking Co. (In re Augie/Restivo Banking Co.)* 860 F.2d 515 (2d Cir. 1988).

[64] Baird (2005-2006), p 21.

[65] *Polly Peck International Plc (In Administration) (No. 4), Re* [1996] 1 BCLC 428.

[66] Bowmer (2000), p 196.

[67] Ibid., p 196.

[68] Van Galen (2012), p 32.

some creditors. Moreover, different companies may have various debt/asset rates and it will destroy creditors' expectations if all the debts and assets of different companies are pooled together. Substantive consolidation may violate the requirement of respecting the non-insolvency law principle as mentioned above.

2.4 Difficulties Arising from the Cross-Border Nature of MCG Insolvency

Another difficulty of MCG rescue is that the insolvency laws of Member States are different. Their insolvency laws may focus on varying policies, such as employment protection and debt collection.[69] For instance, the statutory priority of creditors is the manifestation of the hierarchy of values and policies of Member States.[70] Therefore, it would be almost impossible to reconcile many parallel insolvency proceedings of member companies in the same MCG.

Having said that, whether an MCG insolvency can be administered in only one court under one set of insolvency rules depends on the rules of international insolvency jurisdiction. The current EU legislation that determines international insolvency jurisdiction for a company is the EU Regulation on insolvency proceedings recast, which provides that the insolvency jurisdiction of a company should be allocated to the Member State where the company is registered; the registered place is a rebuttable presumption.[71] Where evidence can show that its centre of main interest (CoMI) is located in a different Member State, the latter Member State should enjoy the insolvency jurisdiction of that company.[72] The CoMI is defined as the place where the head office functions of one company are carried out in a non-transient way and ascertainable to third parties.[73] More importantly, the CoMI is applied to an individual company rather than to an entire MCG.[74]

When it comes to the MCG insolvency setting, it is possible that member companies are subject to different insolvency jurisdictions as their registration places or CoMIs are not necessarily located in the same Member State. Two methods are proposed to solve the problem: procedural consolidation and procedural cooperation.

Procedural consolidation, focusing on insolvency jurisdiction rules, aims to allocate the insolvency proceedings of group members to one court or to as small a number of courts as possible so as to facilitate the administration of multiple insolvency proceedings of a group-wide insolvency case.[75] However, under the definition of CoMI, it is entirely possible that the insolvency jurisdictions of member companies are not in the same country, which indicates a serious limitation of procedural consolidation.

One may choose to design a concept called 'group CoMI' to centrally control the insolvency proceedings and to maximize the recovery of corporate group insolvency for creditors.[76] The group CoMI concept can be defined as the location where the group

[69] Eidenmüller (2016), p 10.

[70] Garrido (2010-2011), p 474.

[71] EIR recast, Art. 3(1) International jurisdiction.

[72] Ibid.

[73] Case C-341/04, *Eurofood IFSC Ltd* [2006] ECR I-3813; Case C-396/09, *Interedil* [2011] ECR I-9915.

[74] Case C-341/04, *Eurofood IFSC Ltd* [2006] ECR I-3813

[75] Mevorach (2009), p 131.

[76] Bufford (2012), p 712.

collectively organizes and manages its interests and is perceptible to third parties.[77] It points to the place where the head office function of an MCG is centrally carried out and controlled.[78]

Such a concept helps centralize insolvency proceedings in one place, especially in terms of types of corporate groups which are business-integrated and centrally controlled by one parent company.[79] The group CoMI will reduce the cost of multiple insolvency proceedings and avoid the difficulty of court-to-court cooperation. The danger is that the group CoMI approach is equal to putting all eggs in one basket since a change of location of the group CoMI will cause a change of applicable law for all creditors in the group, which will dramatically affect their interests. Another problem is that, in practice, the CoMI may not be easily determined as the management teams and assets may be evenly spread among some countries. As a result, the rules of priority of certain local creditors may be replaced by completely different foreign rules of priority,[80] making the local courts reluctant to defer to foreign courts.[81]

Compared to procedural coordination, procedural cooperation is modest and aims to facilitate cooperation and coordination between courts and insolvency practitioners of different Member States. However, it may be too late to rescue an MCG when a group of companies falls into insolvent status; creditors of the group gain significant leverage on different member companies in the group, and multiple insolvency proceedings will tear the group business apart and drain away going-concern value of the group. Even though some debtors and creditors would like to cooperate with each other, differences in national insolvency laws may prevent them from doing so.

Since all these theoretical solutions may have serious limitations as regards resolving the rescue issue of MCGs when a group-wide insolvency has taken place, one may argue that a possible way to preserve the group value is to avoid group-wide insolvency through certain preventive restructuring procedures. The next section will examine preventive restructuring procedures in more detail.

3 The Characteristics of Preventive Restructuring Procedures

On 22 November 2016, the European Commission proposed a Directive on PRFs with the aim of helping distressed companies in the EU with their debt restructurings and avoiding the stigma of insolvency.[82] According to the proposal, the UK schemes of arrangement and the US Chapter 11 Bankruptcy Code are the models on which the PRFs may be based.[83] The word 'preventive' seems to reflect that the current corporate rescue culture has shifted from focusing on post-insolvency to pre-insolvency rescue.[84] This section will examine the main functions of

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77 Bufford (2012), p 716; Janger (2009-2010), p 434.

78 Mevorach (2009), p 8.

79 Mevorach (2009), p 8.

80 Kipnis (2007-2008), p 175.

81 Tung (2001-2002), pp 47-49.

82 Proposal for a Directive of the European Parliament and of the council on preventive restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU, COM(2016) 723 final; Yeowart (2009), p 518.

83 Tollenaar (2017), p 66.

84 Finch (2008), pp 756-757.

PRFs and provide MCG rescue examples by using PRFs.

3.1 Introduction of Preventive Restructuring Frameworks

According to the European Commission's Recommendation, the suggested preventive restructuring frameworks contain mainly six functions: early warning, debtor-in-possession, minimum court involvement, stay, cross-class cram-down, and refinancing.[85] Also, these elements are elaborated in the European Commission's Proposal for a Directive with more details.

Early warning, debtor-in-possession (DIP) and minimum court involvement together reflect that it is important to avoid insolvency by taking restructuring actions at an early stage. This is especially true of MCG rescue cases, as it is extremely difficult to coordinate multiple insolvency proceedings opened in different Member States.

Various legal instruments may be used as early warning tools to monitor the health of companies, such as debtors' accounting and monitoring duties under company and tax law and reporting duties imposed by loan contracts.[86] The early warning test, which varies in different Member States, invariably reveals that the debtor will be in the vicinity of insolvency soon if no actions are taken.[87] In the context of MCG rescue, whether pre-insolvency proceedings can be opened depends on each Member State's insolvency test and early warning test. Where not all member companies are insolvent or qualify for preventive proceedings, the healthy members may not be able to enter insolvency. However, the initiation of pre-insolvency proceedings of some key member companies can send a strong signal to other group members as to whether the latter need to prepare for financial distress or provide certain support and cooperation.

The right to open pre-insolvency proceedings in the EU lies almost exclusively with the debtor in the EU, as the latter possesses the most up-to-date information about a company's financial condition.[88] A PRF is expected in the form of the US Chapter 11 DIP regime as it could provide necessary incentives for the managers to make use of the PRF and consider rescue plans at an early stage.[89] It has also been recognized that DIP creates the least interruption in the business operation and it is likely to preserve the value of the whole business, compared to manager-replacing regimes.[90] The reason is that courts and administrators are not experts in running businesses; courts may have difficulties in making business judgments about approaches to rescuing the business and the best way to achieve the rescue purposes.[91] However, such early actions cannot be taken without any check and balance. The European Commission requires companies which want to initiate the PRF to be, at least, in the likelihood of insolvency[92] with the aim to prevent debtors from forcing creditors to accept unfair terms of

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85 European Commission, Recommendation of 12 March 2014 on a new approach to business failure and insolvency, C(2014) 1500 final.

86 Wessels and Madaus (2017), p 182.

87 Ibid., p 187.

88 Ibid., p 187; McCormack (2017), p 181.

89 Rasmussen (1994); Weijs and Wessels (2015), p 8.

90 Weijs and Wessels (2015), p 9.

91 Rasmussen and Skeel Jr. (1995), p 93.

92 Proposal for a Directive of the European Parliament and of the council on preventive restructuring, insolvency

rescue plans without any justifiable reasons.[93]

The next task for a PRF is to organize the renegotiation process and cure the unworkable capital structure of a financially distressed company. Arguably, to make a debt restructuring plan workable, stay, cram-down and refinancing are three useful tools.[94]

Refinancing tools are important components to a workable PRF, as in many cases fresh money needs to be provided[95] in addition to debt waivers or debt-for-equity swaps; the goal is to resolve the debt-overhang issue.[96] Debt-overhang issues occur where the indebted company cannot borrow money to get rid of distress and invest in profitable opportunities for fear of the possibility that most of the surplus gained will be reaped by existing creditors.[97] As a result, protection and encouragement should be provided to refinancers.

In many MCG restructuring cases the function of stay has been largely substituted by either inter-creditor agreements between senior creditors where those creditors have reached a standstill agreement, or by market devices such as claim trading. If some creditors are not interested in the reorganization, they may simply choose to sell their debts instead of taking any actions.[98]

However, due to the fragmented debts and varying categories of creditors, it can be expected that creditors may have different incentives or views and take individual actions to make companies enter into the status of insolvency; such a move could activate the creditor default swap provision, which provides a better compensation for their debts.[99] It is also possible that certain creditors have no incentive to timely reach a new agreement, because they may buy debts at a very low cost from the market, such that they can bear the cost of delay.[100] Without a stay mechanism, they are under no pressure to enter into any renegotiation with the debtors.[101] Nonetheless, in MCG cases, since most of the debt restructurings are conducted in the holding levels for the purpose of mitigating the disturbance to operating subsidiaries, the stay may mostly affect holding companies.[102] If senior creditors have sophisticated contracts

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and discharge procedures and amending Directive 2012/30/EU, COM(2016) 723 final, recital 16 (hereinafter: the proposed Directive).

93 Eidenmüller and Zwieten (2015), p 12.

94 Payne (2017), p 2.

95 Eidenmüller (2017), p 283.

96 Ayotte and Skeel Jr. (2013), pp 1573-1579.

97 Block-Lieb (2015), pp 504-505.

98 Nonetheless, this argument assumes that the market is highly liquidated and the prices of the sale are satisfactory. Paterson (2014), p 6, p 22.

99 'Proposals for a Restructuring Moratorium—A Consultation. Response of City of London Law Society Insolvency Law Committee', The City of London Law Society 2010, p 2, available at: http://www.citysolicitors.org.uk/attachments/article/119/20101018-Proposals-for-a-Restructuring-Moratorium-Insolvency-Law-Committee.pdf.

100 Paterson (2014), p 23.

101 Ibid., p 23.

102 'Proposals for a Restructuring Moratorium—A Consultation. Response of City of London Law Society Insolvency Law Committee', The City of London Law Society, p 3, available at: http://www.citysolicitors.org.uk/attachments/article/119/20101018-Proposals-for-a-Restructuring-Moratorium-Insolvency-Law-Committee.pdf.

in place to collectively regulate their actions, it is plausible that stay is not urgently required, especially in MCG rescue cases.

Cram-down is a typical insolvency law tool which is used to resolve anti-commons issues where every party has veto power to stop other parties from using resources, giving rise to underuse of the resources.[103] The rationale of cram-down is that creditors do not need to reach unanimous consensus for the reorganization plan to be approved. Stay is employed to resolve the classic common-pool issues where a group of people are competing for inadequate debtors' resources.[104]

Now that the main functions of PRFs have been examined, the next section will take English schemes of arrangement as an example for further analysis. The creditor schemes refer to the schemes of arrangement that are used in corporate restructuring settings, as opposed to other usages.

3.2 Creditor Scheme of Arrangement as a Procedure in PRFs

It is believed that the English scheme of arrangement is a typical PRF,[105] as it bears a resemblance to the features that a PRF may have; and more importantly, having been used by many foreign MCGs to avoid insolvency, the creditor scheme has proven its effectiveness in achieving the goal that the European Commission wishes to reach. Whether creditor schemes of arrangement should be categorized as a preventive restructuring procedure is subject to debate. What matters here is how a scheme of arrangement, with the functions that the Recommendation and Directive proposed, can avoid MCG insolvency. This section will examine the main functions of schemes of arrangement and provide some cases to illustrate their usefulness.

English schemes of arrangement are regulated by Company Act 2006 section 895.[106] In essence, schemes of arrangement could be considered as a compromise between a company and its creditors or members. In other words, schemes of arrangement aim to provide a basic framework for companies, creditors or shareholders to renegotiate plans flexibly if certain requirements have been met. A sufficient connection between a foreign company and England is a jurisdictional standard for using schemes. As long as the loan contracts between debtors and creditors are subject to English law, either including English courts' exclusive jurisdiction clause or not, this sufficient connection test is met.[107]

In typical creditors' schemes, the purpose is usually to restructure the capital structure of distressed companies. It is rare that creditors will agree on debt restructurings by schemes if the companies have no financial difficulties.[108] This enhances the appetite of foreign countries as they can restructure their debt at an earlier stage than in their home countries. Schemes also include cram-down power so that as long as a majority number (75 percent of value) of creditors

[103] Weijs (2012), pp 71-72.

[104] Ibid., p 69.

[105] Tollenaar (2017), p 66.

[106] A scheme of arrangement is 'a compromise or arrangement between a company and its creditors or any class of them, or its members, or any class of them'. Section 895 Company Act 2006.

[107] *Re Rodenstock GmbH* [2011] EWHC 1104 (Ch).

[108] Windsor (2009), p 2.

in each class support a plan, the dissident creditors are bound by the terms.[109] There are mainly three stages for a scheme to come into effect.[110] Firstly, a company needs to notify the courts that a meeting will be convened; then creditors need to vote on the plan and each class needs to approve it. The ensuing stage is for the court to sanction the plan.[111]

The creditor scheme, corresponding to the proposal of the European Commission, is a DIP procedure which causes the least interruption to the directors in the distressed companies in the course of the debt restructuring, as their positions are preserved. Also, it provides a good incentive to directors encouraging them to initiate the restructuring at an early stage, for the same reason.[112] Evidence of EU Member States' rescue law also shows that DIP may effectively contribute to the efficiency of pre-insolvency law, which, in turn, contributes to reducing the non-performing loan in a banking system, deleveraging corporate debts and stimulating economic growth.[113]

Similar to US Chapter 11, English schemes do not condition their usage on insolvency. However, the use of schemes generally heralds that the companies will be in financial difficulties very soon. The early intervention capacity provides a good opportunity for creditors and companies to reach a sustainable deal. Without the capacity to impact the unworkable debt contracts, the creditors may have to wait for default, during which time the value of the companies may significantly decrease.[114]

It is worth noting that the Directive suggests that the PRFs may not necessarily consist of only one procedure. Therefore, there may be some variations with reference to the functions that one specific PRF contains. Also, in different cases, the significance of one function may be much greater than others. One example is that the English schemes of arrangement work very well in many cases without the stay mechanism,[115] but where necessary, schemes could be used along with insolvency proceedings such as administration to gain such a function.[116]

There is no doubt that the cram-down mechanism is a very powerful tool for schemes of arrangement, especially because it can also bind senior creditors prior to insolvency. Some countries have no PRFs with cram-down tools in the pre-insolvency stage, so it is difficult for the creditors to organize themselves so as to avoid insolvency.[117] Claim trading and participation of various categories of financial investors in the debt market make a cram-down mechanism more important than it was before. Restructuring and insolvency practice is fraught with dynamic activities and changes so that creditors have varying views regarding the value of the business and how to preserve their own value; even though there is one moment when

[109] McCormack (2014a), p 826.

[110] Milman (2011), pp 1-4.

[111] Ibid., pp 1-4.

[112] McCormack (2007), p 5.

[113] See generally Carcea et al. (2015).

[114] Payne (2014), p 189.

[115] Kastrinou (2016), p 117.

[116] Explanatory memorandum for European Union document, Commission Recommendation of 12 March 2014 on a new approach to business failure and insolvency, submitted by the Department of Business, Innovation and Skills on April 2014, C(2014) 1500 final, p 4; Milman (2001), pp 145-146.

[117] Kuipers (2012), p 228.

all the creditors can reach a consensus, a few hours later some may change their minds.[118] It is possible that creditors vying for control exacerbate the hold-out issue. Certain creditors may have their own agenda regarding how to restructure the debtors' business while their plan may work against the interest of the creditors in general. This undesirable situation has to be solved by cram-down tools provided by the PRFs.

As mentioned above, in an MCG rescue setting, financial creditors are generally organized by an inter-creditor agreement where the senior creditors make the most important decisions. Cram-down mechanisms in many cases are used to facilitate senior creditors to reach agreements regarding how the MCGs should be rescued and refinanced and how the loss should be allocated. One important goal is to allow businesses to be sold clear of secured rights and guarantees as otherwise considerable transaction costs will be incurred if every transaction is dealt with separately or is strategically blocked by uncooperative creditors.[119]

In some cases, cross-class cram-down[120] is required. Schemes, unlike US Chapter 11, do not allow cross-class cram-down. That is to say, unless all the classes of creditors approve a reorganization plan, the scheme cannot be sanctioned by the courts. However, twinning schemes with administration procedures allow the business to be sold to the buyers under administrators' power, as long as the affected creditors have agreed. As the dissident classes of creditors are out-of-money creditors in such a situation, their approval is not sought by the debtor. Therefore, schemes can achieve the proposed useful cross-class cram-down.[121]

3.3 Examples of MCG Rescue via PRFs

In Sect. 1 of this article, it has been argued that it is difficult to preserve the going-concern value of MCGs due to the organizational form of MCGs and differences between national insolvency laws. The special organizational form of MCGs makes it impossible to consider a group as one company; differences in national corporate rescue laws make it difficult for different jurisdictions to cooperate with each other. It is here that PRFs can play a role in that they aim to avoid group-wide value-destruction insolvency without having to encounter the above-mentioned difficulties.

The main purpose of PRFs is to preserve group going-concern value either by encouraging creditors to renegotiate their loan agreement so as to avoid group-wide insolvency[122] or to sell the whole group to the newly formed companies owned by senior creditors at holding companies level. The recent debt restructuring cases below show that the rescue of MCGs does not necessarily involve all operating subsidiaries in varying Member States; in fact, group insolvency could be avoided by using PRFs. Debtors and senior creditors may exert considerable control and plan to decide how the distressed corporate group will be

[118] Couwenberg and Lubben (2013), pp 46-47.

[119] Ibid., p 60.

[120] Schemes of arrangement can only be effective where every class of creditors approves the plan. Majority numbers of classes cannot cram down minority numbers of classes.

[121] Yeowart (2009), p 529.

[122] The debtor may choose to renegotiate with existing creditors for debt waivers, or be provided with means to sell the assets free of liens to creditors, or be provided with means to offer new creditor super-priority to refinance debts. Ayotte and Skeel Jr. (2013), pp 1573-1579.

restructured.[123] A better way is to restructure debt at an early stage so that the group has more breathing space to devise a proposal without the constraints of traditional insolvency proceedings in different Member States. Such early-stage treatment may achieve a better chance of recovery.[124]

3.3.1 Renegotiation of Debt Agreements at Holding Companies Level

For the purpose of preserving group going-concern value, a useful way is to renegotiate the debt contracts. Where the debts of the groups of companies are mainly incurred at holding companies level, it is possible to avoid group insolvency by reaching a new agreement between debtor holding companies and their creditors. If one debt agreement includes a majority voting clause which allows certain debts to be modified without the approval of all relevant creditors, the hold-out issue will not be serious. However, in practice, only in complex leveraged loan agreements can one find such a clause.[125] To facilitate reaching such a new agreement, certain legal tools with cram-down functions are necessary.

Schemes have the potential to deal with some debt restructurings involving cross-border groups of companies. When one group of companies encounters financial distress, the main task of the schemes is to facilitate parties to reach a new deal, for example, by extension of the maturity date of the debts.[126] If the main borrower of the group is a holding company, the best way may be for a renegotiated deal to be made between the holding company and the senior creditors. The benefit is that there is no need to worry that multiple local insolvency proceedings are opened. The value of the group can be protected as the operating subsidiaries are not disturbed. For example, the new arrangement could include: issuing new shares to provide necessary funds for the group, conducting a debt-for-shares swap to settle part of the due claims, or converting the lower ranked debt to a higher ranked debt in exchange for an extension of debt maturity or waivers.[127] Also, these schemes respect the expectation of those financial creditors as they may draft contracts before lending that prescribe how to control the business and how to distribute the value.

The *Primacom Holding GmbH* case[128] exemplifies a vivid cram-down scheme case[129] where insolvency of an MCG can be avoided by using the UK scheme. In this case, the ultimate parent companies were two companies incorporated in Luxembourg. An intermediate company was Primacom which, along with its subsidiaries, operates mainly in Germany. In this case, most of the loan facilities were owed by Primacom, and the company could not serve its debts when they fell due. As a result, the company was of the opinion that debt restructuring could yield a better result than the German insolvency proceeding, so the company sought recourse

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123 Rasmussen (2007), p 985.

124 Milman (2011), p 2.

125 Howard and Hedger (2014), p 337.

126 *Apcoa Parking (UK) Ltd, Re* [2014] EWHC 997 (Ch).

127 Pilkington (2013), p 151.

128 *Primacom Holding GmbH v. A Group of the Senior Lenders & Credit Agricole* [2011] EWHC 3746 (Ch), [2013] BCC 201.

129 Cram-down schemes mean that the schemes are used to cram down junior financial creditors so that hold-out issues can be mitigated.

to UK schemes on the basis that its financial documents were governed by UK law.[130] The scheme helped the company and its creditors to renegotiate debts.

The scheme provided new liquidity and deleveraged the group. Notably, debts of operating companies were novated to the holding company so that the German directors' duty under German insolvency law requiring directors to file an insolvency petition when the company cannot pay the debt could be avoided.[131] One important part of the deal was that Primacom's parent company agreed to take on certain debts so that Primacom would not be forced into a German insolvency proceeding. The flexibility of the private restructuring solutions provided useful tools to support such planning and debt renegotiation. As a result, a potential cross-border insolvency of a group of companies could be resolved in only one jurisdiction.

The *La Seda* case[132] is another example. The company La Seda, is the Spanish parent company in the group whose main business is packaging substance manufacturing across the EU. The scheme was used to amend senior debts governed by English law with a UK jurisdiction clause.[133] La Seda was the borrower of senior facilities which were guaranteed and secured by most of the group members with their shares.[134] The purpose of the restructuring was to inject new money into the group[135] such that the group would not enter fragmented insolvency proceedings in Member States. As a result, the restructuring gave senior creditors more than 69% recovery, as opposed to insolvency which would have given senior creditors less than 40% recovery. The group used the UK scheme to cram down the dissident minority of senior creditors. The restructuring plan included, among other things, agreements which amended the terms of the senior loan facilities with senior creditors and added more group members as guarantors of the senior loan facilities.[136]

All these cases show that when debt contracts which cause the MCGs distress can be renegotiated, the group can be kept intact. As a result, it is likely that the group going-concern value is also preserved as the operating subsidiaries can be isolated in the restructuring process. Financial creditors may renegotiate contracts in accord with the terms of inter-creditor agreements. This provides certainty to them as well, as they accept the terms when deciding to lend money. However, this option is more likely to be available in concentrated syndicated loan cases. Therefore, one may not assume that all cross-border insolvency cases involving MCGs can be resolved in this way.

3.3.2 Group Pre-Pack Sale

Another way to preserve the going-concern value of a group is to conduct a pre-pack sale of the whole group to new companies formed by senior creditors of the group. In the sale, operating companies will still largely be intact, and junior creditors will bear most loss due to their ranking.

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130 *Primacom Holding GmbH v. A Group of the Senior Lenders &Credit Agricole* [2011] EWHC 3746 (Ch), [2013] BCC 201, p 2.

131 German directors have to file for insolvency within 21 days of the insolvency situation arising. Ibid., p 9.

132 *La Seda De Barcelona SA, Re* [2010] EWHC 1364 (Ch).

133 Ibid., p 1.

134 Asimacopoulos and Bickle (2013), p 105.

135 Ibid., p 108.

136 *La Seda de Barcelona SA, Re* [2010] EWHC 1364 (Ch).

Inter-creditor agreements prescribe the priority and enforcement sale methods amongst financial creditors in an out-of-court fashion.[137] Such a sale may happen at the intermediate holding companies' level so that the group will 'break the neck' and transfer the main assets-operating subsidiaries to the senior creditors.

In many cases, with the help of the contracts and restructuring laws, holding companies could sell the shares of all operating subsidiaries to senior creditors without the claims from junior creditors, provided that junior creditors have security and guarantee given by the operating subsidiaries. Taking the UK law as an example, the above-mentioned aim could be achieved by a transfer scheme and inter-creditor agreement. Transfer schemes allow shares or assets of the operating group to be sold to companies formed by senior creditors while leaving out-of-money creditors behind in the holding companies with little assets. Claims of junior creditors are released by the inter-creditor agreement so that they will not benefit from the assets of the newly formed companies.[138] The aim of the transfer schemes is twofold: one is to cram down unsupportive senior creditors and the other is to allow the new company to be clear of debt of out-of-money creditors so as to avoid insolvency.[139]

The reason why the junior claims could be legally released is because of the inter-creditor agreement's provisions whereby the priority and enforcement method of financial creditors are regulated; one example of the term is as follows:

> (a) the Junior Note-holders may not take any action to enforce their rights while the Senior Liabilities remain outstanding;
> (b) the Secured Parties have no independent power to enforce or have recourse to any of the Transaction Security, or to exercise any rights or powers with respect thereto, except through the Security Agent; […][140]

The fundamental result that an inter-creditor agreement would like to achieve is that the claims, guarantees and securities of junior creditors who, based on the evidence of valuation, have no economic interests in the corporate group, are released along with the security enforcement instructed by the senior creditors. As a result, the senior creditors could maximize the value of the corporate group as it is free of claims and encumbered assets from the junior creditors; it is not unusual that the terms of inter-creditor agreements put the right of control of enforcement in the hands of senior creditors by constraining junior creditors' rights of enforcement.[141] For example, in a European mezzanine inter-creditor agreement, the release provisions stipulate that junior creditors' security and guarantee are automatically released if the senior creditors have instructed the agent to release their security on the debtor's assets in accordance with the senior and second-lien facilities.[142] That is to say that the debtor in the debt restructuring process could sell the whole group encumbered by the security and guarantee of all financial

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137 Hanrahan and Mehta (2014), p 46.

138 Pilkington (2013), p 19.

139 Ibid., p 19.

140 *In the Matter of Christophorus 3 Limited* [2014] EWHC 1162 (Ch), p 3.

141 Hanrahan and Mehta (2014), p 47.

142 Ibid., p 48.

creditors to the Newco formed by the senior creditors free of encumbrance.[143] It has been expounded in *Barclays Bank Plc v. HHY Luxembourg Sàrl*[144] that the operating subsidiaries could be sold to the senior creditors as a whole through a sale of shares in the holding companies, with all the guarantee and security on the assets of subsidiaries released on the basis of release provisions in the inter-creditor agreement between senior financial creditors and junior financial creditors.

The *IMO Car Wash* case[145] is a good example of a pre-pack sale of an insolvent MNC. IMO is the world's largest car wash company group based in the EU across fourteen countries. The group was funded by one senior facility agreement and one mezzanine facility agreement. When the group was in financial difficulties, it decided to transfer the business to Newcos owned by senior creditors with shares apportioned by them. Three of the main holding companies were put in administration to sell the business to the NewCos. The claims of the mezzanine creditors against the subsidiaries of the group were released by the security agent in accord with the inter-creditor agreement.[146] As a consequence, the group was transferred to the senior creditors and the going-concern value was preserved.

The *European Directories* case[147] followed a similar path. The European Directories Group had business in nine EU Member States and used a pre-pack sale of one holding company's shares in one intermediate holding company called DH 7. The fact of this case was that DH 6 and DH 7 were companies incorporated in the Netherlands. One intermediate holding company DH 6 owned shares of another intermediate DH 7 which, in turn, owned shares in the operating subsidiaries in the group. DH 6, the shareholder of DH7, sold the shares of DH 7. As a result, all operating subsidiaries in the insolvent MNC were sold to senior creditors. As the operating subsidiaries were kept intact, the group going-concern value was preserved. The inter-creditor agreement allowed the junior claims to be released on enforcement action by senior creditors.[148]

4. An Evaluation of PRFs in the Light of MCG Rescue

4.1 The Nature of PRFs

One essential feature of insolvency proceedings is that they are collective proceedings dealing with common pool issues (creditors taking individual actions) and anti-commons issues (hold-out); insolvency proceedings generally impose a stay on creditors and provide a structured framework for all creditors to negotiate a reorganization plan in reorganization settings or an assets distribution plan in liquidation settings approved by the majority of creditors or

143 Hooley (2012), p 214.

144 *Barclays Bank Plc v. HHY Luxembourg Sàrl* [2011] 1 BCLC 336.

145 *Re Bluebrook Ltd* [2010] BCC 209.

146 Ibid.; Asimacopoulos and Bickle (2013), p 26.

147 *HHY Luxembourg S.A.R.L & Anr v. Barclays Bank PLC &Ors* [2010] EWHC 2406.

148 Asimacopoulos and Bickle (2013), p 181.

sanctioned by courts.[149] To overcome those collective issues, insolvency laws are equipped with stay and cram-down mechanisms to facilitate creditors and debtors to arrive at a new rescue plan. In Sect. 2, it has been argued that in the corporate rescue spectrum, insolvency law and PRFs all aim to protect creditors by preserving the going-concern value of the debtors and by maximizing creditors' recovery. Corporate rescue law can play an important role when financially distressed companies with going-concern value cannot be saved by a private workout and a ready sale in the market.[150] Preventive restructuring procedures bring timing of rescue forward as otherwise it would be too late to preserve the going-concern value.[151]

Even though some PRF proceedings may not rely on an insolvency test, they all require a justification to modify creditors' interests. For example, though US Chapter 11 can be initiated without an insolvency test, it requires a good-faith test whereby the necessity to use Chapter 11 for reorganization or a business sale needs to be proven.[152] The key rationale for initiating PRFs is that without their intervention, it is inevitable that the debtor will enter into insolvency.[153]

Since preventive restructuring procedures aim to achieve the general goals of traditional corporate rescue law and should apply in situations where insolvency of the distressed companies is foreseeable, they need the same tools to deal with collective issues such as commons and anti-commons.[154] It is true that common pool issues arise in the vicinity of insolvency as creditors know that if they do not take active action to request payment, they may not be paid.[155] Therefore, one may argue that preventive restructuring proceedings can be categorized as insolvency-related proceedings.

4.2 The Relationship between PRFs and EIR Recast

PRFs are designed to improve the effectiveness of national preventive restructuring procedures, with the intention to complement EIR recast.[156] The EIR has extended its scope to incorporate pre-insolvency proceedings and hybrid proceedings and it seems safe to reason that the newly devised national preventive restructuring procedures should all fit into the scope of EIR recast.[157] This is the basic relationship between PRFs and EIR recast.

What is worth noting is that Article 1 of EIR recast on the scope of the Regulation may in fact exclude certain preventive restructuring procedures from its ambit. To qualify as a procedure in EIR recast, some requirements must be met: the procedure should be public, collective, be based on the law relating to insolvency and have certain effects.[158]

The first condition for a preventive restructuring procedure to be able to be included in EIR recast is that it should be 'public' as opposed to 'confidential'. The publicity requirement is said

[149] Weijs (2012); Eidenmueller (2016).

[150] Rasmussen (2016), p 3.

[151] Goodwill or important licence loss in costly insolvency proceedings.

[152] McCormack (2017), p 181.

[153] Tollenaar (2017) p 74.

[154] Weijs (2012).

[155] Block-Lieb (1992-1993), pp 378-379.

[156] COM(2016) 723 final p 9.

[157] Eidenmueller (2016), p 7.

[158] EIR recast, Art. 1.

to help ascertain claims and to allow creditors to challenge jurisdiction.[159] Also, a certain degree of publicity enables creditors in other countries to be noticed and participate in the renegotiation.[160] Schemes require publicity of the main provisions of debt restructuring plans, and key financial agreements need to be made available to the scheme creditors for checking.[161]

Collectivity, as opposed to individual creditors' actions,[162] reveals that the insolvency proceedings should aim to deal with issues for a majority of the stakeholders, while it does not mean that all the creditors of one debtor need to be involved if those who are left out are unaffected.[163] The Regulation provides that in many group cases it is possible that the proceeding only includes a significant part of creditors, i.e. financial creditors, provided that other creditors are unaffected.[164] In many rescue cases of large MCGs, financial creditors at the holding companies' level will offer to bear most of the losses of restructuring via schemes of arrangement if they are confident about the value and future of the distressed MCGs.[165] This means that schemes of arrangement may only need to deal with financial creditors who are also the majority of creditors in terms of their value of claims in an MCG.[166] The schemes have a collective nature in the sense that the court needs to consider the whole situation of the debtor and all creditors and the plan is binding on all creditors.[167]

Creditor schemes are insolvency-related procedures especially when they are used to conduct debt restructuring so as to avoid insolvency.[168] As mentioned above, preventive restructuring and traditional corporate rescue procedures aim to achieve the same goals.[169] In the MCG rescue setting, the purpose of a creditor scheme, as a form of PRF, is to protect creditors by preserving the value of the group, which is one important purpose that insolvency law aims to achieve.

EIR recast prescribes a further requirement regarding an insolvency or preventive insolvency proceeding, i.e. that such a proceeding should be subject either to the control of an insolvency practitioner, or to the supervision of a court.[170] In the case of creditor schemes, the English courts also need to ascertain that the proposed scheme is fair to all creditors.[171] The compromise plan between debtors and creditors needs to be sanctioned by the courts.[172] This requirement, though, increases cost due to the court involvement but also provides judicial

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159 Moss, Fletcher and Isaacs (2016), p 423.

160 Garcimartín (2016a), p 5.

161 See section 897 of Company Act 2006 in general. see also Windsor (2009), p 3.

162 Wessels (2011).

163 Wessels (2015), p 3.

164 EIR recast, Art. 2(1): '"collective proceedings" means proceedings which include all or a significant part of a debtor's creditors, provided that, in the latter case, the proceedings do not affect the claims of creditors which are not involved in them'.

165 Paterson (2017), p 4.

166 Wessels (2016), p 131.

167 Bork and Mangano (2016), p 67.

168 Kastrinou (2016), p 117; Payne (2014), p 315.

169 See Sects. 2.2, 4.1.

170 Moss, Fletcher and Isaacs (2016), p 74.

171 McCormack (2014b), p 47.

172 Milman (2011), p 2.

protection.[173] Therefore, schemes of arrangement can be said to be under court supervision.

It seems that creditor schemes meet many of the requirements to be able to fall under EIR recast;[174] nonetheless, the story has a twist. Recital 16 EIR explicitly prescribes that preventive restructuring procedures which fall under company law but not exclusively under insolvency law are outside the scope of the Regulation.[175] Apparently, this will affect the status of schemes of arrangement as they come under company law and can be used for purposes other than debt restructurings.[176] However, it may be just a matter of characterization and does not change the essence of creditor schemes.

Most importantly, a recent ECJ case has reflected the mainstream opinion on the boundaries of the scope of EIR. In *Bank Handlowy*, the court held that as long as a proceeding is listed in Annex A of EIR recast, it should be regarded as being within the scope of EIR recast and such effect is direct and binding.[177] As a result, since the UK government deliberately leaves schemes outside of EIR recast Annex A, creditor schemes are not preventive restructuring procedures.

It is true that some existing preventive restructuring procedures not fully meet the requirements of EIR recast but are still recognized by Member States simply because those procedures are listed in Annex A. What matters is not whether schemes of arrangement should be put in Annex A; what matters is what benefit Member State can receive by putting its preventive restructuring procedures with similar functions within the scope of EIR, especially for MCG rescue. This question will be examined in the next sections.

4.3 PRFs and EIR Group Coordination Proceedings

It has been recognized that ineffective insolvency law of some Member States adversely affects the restructuring of cross-border groups of companies.[178] This article has shown that PRFs may supplement the existing MCG rescue solutions mentioned in Sect. 1 and improve the effectiveness of certain Member States' insolvency law in preserving the value of MCGs.[179] The main goal that PRFs aim to achieve is to restructure financially distressed companies at an early stage and to avoid their insolvency.[180] Without mechanisms to avoid insolvency, there will be no effective solutions if an MCG has entered into free-fall insolvency in multiple Member States. Due to differences in national restructuring law and insolvency law, it is difficult, if not impossible, for courts and insolvency practitioners to cooperate with each other to preserve the value of a distressed MCG.

Nonetheless, the difficulties may be slightly eased by EIR recast. It introduces two

173 Schemes involve two court hearings. See Payne (2013), p 566.

174 McCormack (2014b), p 48.

175 Recital 16 of EIR recast.

176 Charnley and Milman (2013), p 1.

177 Case C-116/11, *Bank Handlowy w Warzawie SA v. Christianapol sp. Z.o.o,* ECLI:EU:C:2012:739, [2013] Bus LR 956.

178 European Commission, Initiative on insolvency inception impact assessment (2006), http://ec.europa.eu/smart-regulation/roadmaps/docs/2016_just_025_insolvency_en.pdf (accessed 6 June 2017), p 3.

179 Howard and Hedger (2014), p 237.

180 The proposed Directive pp 5-6.

developments concerning MCG rescue: the obligations for courts and insolvency practitioners appointed in preventive restructuring proceedings or insolvency proceedings of different distressed companies in the same group to cooperate and communicate; a brand new group coordination proceeding.[181] EIR has made clear that it does not adopt a procedural or substantive consolidation approach to MCG rescue; rather, it takes a modest procedural cooperation approach by encouraging insolvency practitioners and courts of different companies in the same group to communicate and coordinate with each other.[182] The obligations of cooperation are imposed on the courts and insolvency practitioners in the opening insolvency proceedings, not including insolvency proceedings that have not yet been initiated.[183]

Chapter V of EIR recast is devoted to a group of companies; in its first part, besides general obligations for courts and insolvency practitioners to cooperate with each other, it grants three powers to insolvency practitioners to facilitate cooperation: 1) the right to be heard in foreign courts; 2) the right to request a stay and consider coordinated restructuring plans; 3) the right to apply for group coordination proceedings.[184] Communication and cooperation can increase the flow of information exchange which is key to a successful restructuring at the pre-insolvency stage.[185]

In addition to the general requirements for cooperation and communication between insolvency practitioners and courts, Chapter V further specifically prescribes group coordination proceedings for MCGs.[186] The key function of group coordination proceedings is to provide a platform for coordinators to consider a group coordination plan[187] at an early stage[188] and explore whether a better group-wide rescue option, be it extending debt maturity or selling group assets to repay debt, is available.[189] Possible examples could be that the relevant group member companies which join the proceeding may decide to draft a coordinated recovery plan by extending debt maturity or selling group assets to repay debts.[190]

The coordinator in group coordination proceedings enjoys an enhanced power to impose a stay[191] on insolvency or pre-insolvency proceedings of member companies, which can be used not only for a coordinated sale of the group assets enjoyed by the insolvency practitioners should the group coordination proceeding not be opened, but also for the rescue of companies.[192] The stay power, to some degree, eases the 'common pool issue' especially when

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181 Chapter V EIR recast.

182 Art. 72(3) EIR recast; Madaus (2015), p 237.

183 Bork and Van Zwieten (2016), p 592.

184 Arts. 56-58 EIR recast; Bork and Mangano (2016), p 287.

185 Howard and Hedger (2014).

186 EIR recast 2015, Chapter V.

187 Art. 72(1)(b) EIR recast.

188 Howard and Hedger (2014).

189 Moss, Fletcher and Isaacs (2016), p 516; Madaus (2015), p 244.

190 However, such a plan should not include substantive consolidation as it may fundamentally change the creditors' pre-insolvency rights without justification. Moss, Fletcher, Isaacs (2016), p 516.

191 EIR recast, Art. 72.

192 See Art. 60(b) EIR recast. See also Moss, Fletcher, Isaacs (2016), p 516.

a subsidiary aims to pursue a different goal.[193]

Companies belonging to the same MCG may not necessarily be registered (or have their CoMIs located) in the same Member State and be subject to only one set of insolvency rules.[194] Imagine if member companies are registered in more than one European country, the consequence will be that multiple preventive restructuring proceedings need to be opened. In the latter cases, PRFs and EIR group coordination proceedings may work together to avoid group-wide insolvency. Imagine a case where a group of financial creditors lends loans to two holding companies which in turn lend to their subsidiaries. It is possible for the subsidiaries group to push up the debts to the holding level so that two holding companies can conduct a debt-for-equity swap with the help of preventive restructuring procedures.[195] The coordinated rescue plan facilitated by the group coordinator as mentioned above has a better chance to be successful due to better communication and coordination of insolvency practitioners and courts. Therefore, group-wide insolvency can be avoided by only putting two holding companies into preventive restructuring proceedings under the aegis of EIR recast.

More importantly, if the above preventive restructuring procedures are listed in Annex A of EIR recast, the possible stay imposed by the procedures and the legal effect of the swap plans will be automatically recognized by other Member States so that the creditors cannot take individual debt collection actions in other Member States and no other main proceedings against the same debtor can be opened in other Member States.[196]

Even though insolvency practitioners of one subsidiary in the same group can opt out from group coordination proceedings,[197] EIR recast imposes an obligation on the insolvency practitioners to consider the group rescue option at an early stage before considering opt-out.[198] Therefore, when two pre-insolvency proceedings are opened in two Member States, the insolvency practitioners and courts should work together to consider whether a group rescue option is available to all stakeholders at an early stage. The group coordination proceeding will provide a cooperative framework to achieve possible good results. The harmonized PRFs will also reduce the difficulties of coordination as they make national preventive restructuring procedures converge. As a result, the interaction between EIR and PRFs may increase the chances of preservation of the group going-concern value.

4.4 Improved Commercial Certainty

Since EIR Recast has extended its scope to include PRFs, rescue plans under the harmonized PRFs may enjoy the benefit of automatic recognition under EIR. That is to say, if one PRF is listed in Annex A of EIR recast, the possibility of rejection of a rescue plan under that PRF is

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193 Insolvency practitioners under EIR recast enjoy general stay power which can be used if certain requirements are met, in other insolvency proceedings. One of the requirements is a reasonable chance of success; another is that such stay benefits the member company on which the stay is imposed. Art. 60(i)(iii) EIR recast.

194 *Collins & Aikman* [2006] BCC 861.

195 Howard and Hedger (2014), p 391.

196 Art. 20 EIR recast; Bork and van Zwieten (2016), p 76; Garcimartín (2016b), pp 83-84.

197 Art. 64 EIR recast.

198 See EIR recast, recital 58 and Art. 56. See also Zhang (2017), p 346.

significantly reduced by other Member States.[199]

The PRFs will easily gain recognition by countries outside of the EU if those countries adopt the UNCITRAL Model Law.[200] The UNCITRAL Model Law on cross-border insolvency adopts a similar CoMI concept so that foreign courts only bear an obligation to recognize the main proceeding initiated in the jurisdiction where the CoMI is located, while the non-main proceeding can only get recognition with the discretion of foreign courts.[201] As many MCGs may borrow the US high-yield bonds under US law, gaining the recognition of US courts is very important for MCG rescue.

By contrast, the English scheme gives rise to some uncertainty regarding its jurisdictional rules and difficulty of recognition. The jurisdiction test of schemes is the 'sufficient connection test' which is much easier to pass than the 'CoMI test' of insolvency proceedings regulated by EIR. English courts could claim the scheme jurisdiction of one foreign company irrespective of the fact that its CoMI and establishment are in another country as long as the sufficient connection test is met.[202] In fact, the sufficient connection test is very favourable to English courts as in practice many loan contracts are dealt with by English law due to the UK's powerful position in the EU financial area.[203]

The *Van Gansewinkel Groep BV* case[204] is an example where the English courts decided to sanction the schemes for six foreign operating subsidiaries in the group. What puts this case in the spotlight is that none of these companies' CoMIs or establishments are in the UK, whereas the only connection to the UK is the senior facility agreement governed by English law.[205] The English court found a good reason, besides the sufficient connection test, to assume jurisdiction, i.e. that the home countries have no equivalent debt restructuring tools to prevent the MCG from entering into multiple value-destroying insolvency proceedings in different Member States.[206] In some cases, the MCGs may have no connections to the UK prior to debt restructurings.[207] Sometimes, the sufficient connection was intentionally set up for the purpose of using the English schemes.[208] In the *Apcoa* case, the governing law of credit contracts had been changed to English law so as to build up a sufficient connection to the UK. One key process of the restructuring was to extend the maturity of the debts borrowed by nine borrowers through schemes of arrangement in the group so as to avoid formal insolvency proceedings of the whole group. In this case, the UK court found a good reason to sanction the schemes, as without the schemes, there would be no alternative way for the corporate group to avoid group-wide insolvency.

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199 *Rechtbank 's-Gravenhage* (District Court of The Hague), 10 June 2010, ECLI:NL:RBSGR:2010:BN9604 (Dutch courts agree that the pre-insolvency procedures in the case should not have an effect on German creditors as they are not granted recognition by EIR), in Bork and Mangano (2016), p 66.

200 UNCITRAL Model Law on Cross-Border Insolvency (1997).

201 Ibid., Art. 17(2).

202 *In Re Dap Holding NV* [2005] EWHC 2092 (Ch); Kortmann and Veder (2015), p 245.

203 Pilkington (2013), p 65.

204 *In re Van Gansewinkel Groep BV and others* [2015] EWHC 2151 (Ch).

205 Ibid., p 5.

206 *In re Van Gansewinkel Groep BV and others* [2015] EWHC 2151 (Ch), p 10.

207 *Re Magyar Telecom BV* [2013] EWHC 3800 (Ch).

208 *Re APCOA Parking (UK) Ltd* [2014] EWHC 1867 (Ch).

English courts do not rubber stamp the schemes without sufficient connection,[209] even if they can be beneficial to creditors and are supported by them.[210] However, UK courts seem to be delighted to accommodate these foreign companies by using a low-threshold jurisdictional test even though some only have little connection to the UK.[211] The broad jurisdiction may cause concerns about the recognition issue in the cases of the insolvency of foreign companies.[212] English schemes falling outside EIR claim broad jurisdiction at the expense of automatic recognition.[213] It is possible for dissident senior creditors who have different visions of the future of the distressed group to challenge the schemes in the countries with CoMIs of the companies.[214] As a result, creditors may sometimes choose other insolvency proceedings or link schemes with other insolvency proceedings to ensure recognition by other Member States. For example, in the *Schefenacker plc* case, creditors chose a company voluntary arrangement (CVA) rather than schemes for fear of not being recognized by German courts.[215]

To mitigate the concern that schemes may not be recognized by foreign courts, foreign experts' opinions are a very important element for the UK courts to make decisions.[216] Such a case-by-case *ad hoc* approach may cause uncertainty and inconsistency. In addition, even if the English courts seize the jurisdiction, the complicated corporate structures of groups of companies and capital structures may stand in the way of recognition of schemes in other countries, especially the country of incorporation and CoMI.[217] For the purpose of ensuring that the proposed schemes can be recognized, it is not uncommon for the companies to consider moving the CoMI or creating other connection points to the UK. All these moves create costs and uncertainty.

Without automatic recognition endowed by EIR, schemes should find other conduits for recognition. The most frequently mentioned alternatives are the Brussels I[218] and Rome I Regulations.[219]

English courts are not entirely clear about how the schemes fall into the Brussels I Regulation and under what circumstances they are entitled to sanction foreign schemes.[220] What is clear is that the Brussels I Regulation clearly excludes its application to insolvency proceedings.[221] As EIR and Brussels I are intended to dovetail with each other, if the creditor

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209 *In re Drax Holdings Ltd* [2004] 1 WLR 1049, p 7, see also *Re DAP Holding NV* [2006] BCC 48.

210 Milman (2016), pp 2-3.

211 Ibid., pp 2-3.

212 Omar (2014), p 6.

213 McCormack (2014b), p 48.

214 Perera and Mendiola (2015), p 4.

215 Payne (2014), p 239.

216 Ibid., p 313.

217 Pilkington (2013), p 65.

218 Regulation (EU) No. 1215/2012 of the European Parliament and of the Council on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (Brussels I Regulation) [2012] OJ L 351/1-32.

219 Regulation (EC) No. 593/2008 of the European Parliament and of the Council, of 17 June 2008 on the law applicable to contractual obligations (Rome I Regulation) [2008] OJ L 177/6-16.

220 Kortmann and Veder (2015), p 250.

221 Art. 1(2)(b) Brussels I Regulation; Payne (2014), p 312.

schemes fall outside EIR, creditor schemes should fall under Brussels I.[222] However, it is worth noting that EIR recast makes clear that procedures which are not in Annex A cannot be construed as automatically falling within the scope of the Brussels I Regulation.[223]

Also, another restriction that prevents schemes from being recognized under the Brussels I Regulation is that the proceedings need to be adversary in nature, i.e. there should be plaintiffs and defendants involved.[224] Nonetheless, PRFs are not adversary proceedings and the main purpose of PRFs is to avoid disputes between creditors and debtors and rescue the business.[225] Moreover, some mechanisms of PRFs including cram-down may have an effect on third parties so that they are not limited to a two-party relationship.

It is also not entirely clear whether schemes could be recognized under the Rome I Regulation. The Rome I Regulation is a set of private international rules applicable to contractual obligations. It allows parties to freely choose the contract law; the law of another country that has a closer connection to the contracts in question should also be respected.[226]

Applying Rome I as a basis to recognize English schemes presupposes that a creditor scheme is a contract. As a result, UK courts may only have jurisdiction to sanction creditor schemes if English law is chosen by creditors to regulate the loan contracts.[227] Given their contractual nature, schemes should not cram down dissident parties to accept the compromises.[228] Moreover, distressed companies may have loan contracts which are not governed by English law, so the creditors governed by other countries' law can ignore the consequence of the schemes but free-ride on the benefits gained from the compromise.[229]

Taking Brexit into account, the options to rely on EIR and other EU regulations to recognize creditor schemes may be significantly reduced.[230] Therefore, it is better for other Member States to improve their own PRF versions.

Hence, the harmonized PRFs, by working with EIR, provide a better alignment of jurisdiction rules among EIR, Brussels I and Rome I and increase commercial certainty. PRFs also avoid unnecessary and costly forum shopping for English schemes simply because the home country has no equivalent PRFs. One may envisage that if other countries keep developing preventive insolvency proceedings, the English schemes may not be as popular as they are today for foreign companies.[231]

4.5 Other Benefits Brought by PRFs

The harmonization of PRFs may potentially bring the EU some other benefits due to the close relationship between restructuring law/insolvency law and economic growth. Insolvency law

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222 *Re Rodenstock GmbH* [2011] EWHC 1104 (Ch).

223 EIR recast, recital 7.

224 Kuipers (2012), p 235; Kortmann and Veder (2015), p 256.

225 Baird and Morrison (2005), p 953.

226 Rome I Regulation, Art. 3.

227 Kortmann and Veder (2015), p 254.

228 Ibid., p 254.

229 Windsor (2010), p 527.

230 See Armour et al. (2017), p 5 (arguing that the Brexit may render UK unable to use EIR recast).

231 Best and Pacey (2014), p 122.

supports economic development by allocating resources to the entities or persons who can use them in the most efficient way.[232] Compared to other developed countries outside the EU, such as the US, inefficient insolvency law may also lead to a large volume of bank's non-performing debts, high costs of cross-border insolvency, insolvency stigma, inability to save economically viable companies, and low economic growth rate.[233]

It is believed that the harmonized PRFs will contribute to a well-functioning pan-European equity and debt market by making corporate restructuring laws similar, easing the difficulty of assessing risks from different insolvency laws and attracting investment to the EU due to an improved debt recovery rate.[234]

Moreover, the harmonized PRFs improve free movement of capital. Given that some Member States are plagued by lacking PRFs or ineffective insolvency laws, such an undesirable situation restricts borrowers and lenders from advancing loans or buying shares; it also prevents free movement of capital in that one national law should not deter borrowing from foreign lenders or lending loans to borrowers from other Member States.[235] Effective PRFs would provide creditors with maximum returns so as to the lower the interest rates of borrowing and incentivize more investment.[236] This corresponds to the EU strategies calling for building a capital market to lower interest rates and broaden sources of finance.[237]

5 Conclusion

When an insolvent MCG enters the insolvent status, it is difficult to find effective rescue solutions due to obstacles created by differences in national insolvency laws and the organizational form of corporate groups. The European Commission's proposal for a Directive on harmonized PRFs may provide a useful solution to avoid group-wide insolvency for creditors at an early stage. The proposal not only provides creditors with useful tools to overcome collective issues that insolvency law encounters, but also offers mechanisms such as early warning tools or Debtor-in-possession mechanism. These tools allow debtors and creditors to take timely actions. PRFs give creditors more time to plan debt restructurings with the debtor so that the financial issues may be solved in only one or a few jurisdictions. Also, the group coordination proceedings in EIR recast will enhance the efficacy of PRFs by providing a platform for cooperation and coordination if there is more than one preventive restructuring procedure opened in different EU Member States.

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232 Jackson and Skeel, Jr. (2013), p 2.

233 European Commission, Initiative on insolvency inception impact assessment (2006), http://ec.europa.eu/smart-regulation/roadmaps/docs/2016_just_025_insolvency_en.pdf (accessed 6 June 2017), p 3.

234 European Commission, Initiative on insolvency inception impact assessment (2006), http://ec.europa.eu/smart-regulation/roadmaps/docs/2016_just_025_insolvency_en.pdf (accessed 6 June 2017), p 3; Green paper, Building a Capital Markets Union, COM(2015) 63 final, p 25.

235 Art. 63(1) TFEU; Storey and Turner (2014), p 184.

236 Schwartz (2005), p 1220.

237 Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of Regions, COM(2015) 550 final, p 1.

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